Supreme Court, U. S.
FILED
MAR 3 1976

No. 75-354

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# Supreme Court of the United States

October Term, 1975

THE FIRST BOSTON CORPORATION,

*Petitioner,*

*v.*

CHRIS-CRAFT INDUSTRIES, INC., *et al.*,

*Respondents.*

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

## FIRST BOSTON'S REPLY TO THE GOVERNMENT'S BRIEF

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The Government acknowledges that the liability issues presented by this case are federal questions of "substantial importance" (Brief 17, 20), that the damage issue is also "important" because "use of an incorrect measure could distort the allocation of risks in contests for control" (Brief 24) and that the damages awarded below were excessive by $15,000,000 (Brief 23, n. 14). The Government even in effect fully concedes that one issue—the scope of First Boston's liability as an underwriter—merits certiorari (Brief 20-21 & n. 12).

But having thus made out a case for review, the Government's brief shifts to partisan argument on the merits, to favor the open-ended application of the securities laws that was rejected by the Court in *Blue Chip Stamps*, therefore concluding that review on certiorari is "unwarranted"—meaning that review is "unwanted" by the SEC.

Seeking to preserve the decision below at all costs for its *in terrorem* enforcement effect, the Government:

> (1) Accords the narrowest possible construction to the Court's opinion in *Blue Chip Stamps* and refuses to recognize a conflict between the Second and Ninth circuits that has arisen since our petition;
>
> (2) Ignores the fundamental question raised by an award of $36,000,000 based on a conclusive presumption of causation;
>
> (3) Assumes that an underwriter's failure to discharge the duty of due diligence under the 1933 Act is the equivalent of *scienter* under the 1934 Act; and
>
> (4) Dismisses as a pointless exercise Congress' deliberate and "most important" amendment of the 1933 Act to set an absolute maximum limit on an underwriter's liability.

The errors and omissions in the Government's presentation serve to underscore the conclusion that plenary review of the issues of federal law presented by this case, and recognized by the Government to be of "substantial importance," is warranted. *See* Sup. Ct. R. 19.

## I.

*"Standing."* The Court in *Blue Chip Stamps* strongly cautioned against expansive judicial creation of implied actions under the securities laws, particularly when follow-



ing such a course would go beyond the bounds established by Congress for comparable express actions.

The Government argues (Brief 13-16) that the teaching of *Blue Chip Stamps* is inapplicable here because Section 14(e), unlike Section 10(b), is not expressly limited to "the purchase or sale" of securities, but speaks of "solicitation of security holders in opposition to or in favor of any [tender] offer." From the words "solicitation . . . in opposition," and nothing more, the Government concludes (Brief 14-15) that "by its express terms" the protection of Section 14(e) extends beyond the shareholders to whom such solicitations are addressed to include tender offerors themselves.

It is not a "buyer or seller" requirement that precludes standing here. The point is that the statutory language "in opposition" is clearly and *expressly* directed only at protecting public "security holders" from being misled into rejecting an advantageous offer. And the legislative history of the Williams Act shows that Congress was concerned with "protection of investors" and affording "shareholders a fair opportunity to make their decision" —not with creating a new federal law of "unfair competition" involving a whole panoply of rights and duties of contestants for control *inter sese*.

This was explicitly recognized by the Ninth Circuit's recent decision in *Klaus* v. *Hi-Shear Corp.*, CCH FED. SEC. L. REP. ¶ 95,404, at 99,068 (Dec. 15, 1975), which, though dismissed by the Government in a footnote (Brief 18, n. 9), directly conflicts with the decision below. Citing this Court's *Rondeau* decision, the Ninth Circuit squarely held that a contestant for control was not within the class pro-

tected by Section 14(e), since "the Williams Act was designed to protect cash tender offerees, not offerors."[1]

*Causation.* The Government fails entirely to justify the Court of Appeals' conclusive presumption that the omission of the BAR offer from the Bangor Punta registration statement *caused* Bangor Punta's exchange offer to succeed and the court's further conclusive presumption that the success of that particular offer *caused* Chris-Craft to lose the contest for control by providing a margin of victory that would not otherwise have been achieved.

The facts were directly contrary to the presumptions. The undisputed evidence showed that the sale of the BAR enhanced the value of Bangor Punta's securities (Pet. 4, n. 3), and there was no evidence that any shareholder would have tendered to Chris-Craft rather than Bangor Punta had he known of the BAR offer (A145). Further, Bangor Punta acquired the remaining shares it needed for control by cash purchases and could have acquired more by the same means (A18). In the face of these record facts, the award of massive damages by presumptions as to causation may fairly be characterized as a denial of due process.

*Scienter.* While properly supporting certiorari on the scope of First Boston's liability as an underwriter, the

[1] *Smallwood* v. *Pearl Brewing Co.*, 489 F.2d 579 (5th Cir. 1974), represented by the Government to be in accord with the decision below (Brief 17-18), dealt with the right to sue of a nontendering shareholder, not a contestant for control, and cited the decision below only perfunctorily in a footnote discussing general concepts. *H. K. Porter Co.* v. *Nicholson File Co.*, 482 F.2d 421, 424-25 (1st Cir. 1973), granted a tender offeror a right of action, but expressly cautioned that "the overriding purpose of § 14(e) is the protection of the investor" and that it "may not be diverted from one designed to assist the investor to one operated principally to benefit one or another of the rival management or control groups jockeying for power."



Government begs the question on the merits of the issue by merely repeating the Court of Appeals' conclusory statements as to *scienter*. In point of fact, each judge on the panel below expressly upheld the District Court's finding of "good faith": Judge Timbers in the majority opinion on liability (A47), Judge Gurfein in the majority opinion on injunctive relief (A97-98) and Judge Mansfield in his concurring opinion (A118-119).[2]

All the Court of Appeals' rhetoric about First Boston's "abdication" of responsibility is premised on its "duty of due diligence" as an underwriter pursuant to Section 11 of the 1933 Act. An "unintentional" error made in "good faith" is transformed into *scienter* for 1934 Act purposes only because of the underwriter's special duty under Section 11. But that duty *extends only to purchasers of registered securities.* Equating its breach with a violation of the 1934 Act in order to extend its liability to others makes a mockery of both Section 11's express limitations on liability and the 1934 Act's *scienter* requirement.

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In sum, there are substantial reasons for questioning the "manifest correctness" of affording a contestant for control an implied action for damages under Section 14(e): as this case shows, such actions place honest businessmen in peril of massive damages on the basis of a court's after-the-fact disagreement with their good-faith assessment of proper disclosure and inherently create the opportunity for speculative recoveries of the sort condemned by the Court in *Blue Chip Stamps.* Witness just

[2] Resolution of *Ernst & Ernst* v. *Hochfelder*, No. 74-1042, to require "bad faith" for "scienter" would certainly preclude liability here.

the fact that the District Court, the Court of Appeals and the Government's brief have come up with three different measures of damages.

## II.

*Damage Limitation.* The Government incredibly suggests that the damage limitation provision of Section 11 "simply recognizes that the loss suffered by a defrauded purchaser will not exceed the price he paid for the securities." (Brief 19). What Congress sought to do in the "most important" amendment to the 1933 Act was not merely to recognize inescapable fact.

Under the Act in its original form any one member of an underwriting syndicate could have been held liable for the full amount of an issue of securities. Recognizing the danger of so extreme an exposure to the investment banking industry, Congress in 1934 amended the Act to provide that "in no event" shall an underwriter be held liable for damages in excess of the offering price of the securities underwritten by him. In other words, the exposure of any underwriter is limited to his participation, even though others liable may have become insolvent and some purchasers are thereby left without any recourse.

Even if the issues of standing, causation and *scienter* were resolved in favor of Chris-Craft, the care taken by Congress to limit the amount of an underwriter's liability —in the only instance in which it directed its attention to that question—should absolutely preclude the imposition of greater damages in a judicially implied action under another statutory provision.



In rejecting Congress' express limitation intended to preserve and protect the public interest in the capital formation process, the decision below has raised a question of the first importance, which surely merits this Court's review. The Government's now taking a position in opposition to such review defies understanding in view of the position it took in the Court of Appeals in support of First Boston's petition for a rehearing.[3]

*Measure of Damages.* The Government acknowledges the importance of the issue as to measure of damages (Brief 24) and concedes both that the Court of Appeals' basic damage formula was in error (Brief 21-23) and that, *in addition,* the award was excessive by the amount of $15 per share, or a total including interest of $15,000,000, because that amount represented a market decline (Brief 23, n. 14).

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[3] In the Court of Appeals the SEC supported the petition on both the issue of the limitation on First Boston's liability and the propriety of holding First Boston jointly and severally liable with the other defendants, who were held to have committed additional and separate violations of the 1934 Act. A comparison of its two briefs is dramatic:

| *Before the Court of Appeals* | *Before this Court* |
|---|---|
| "As suggested by First Boston's petition and by the brief in support of rehearing tendered by the Securities Industry Association, answers to these questions may have a wide-ranging impact upon the investment banking industry, upon the nation's economy and upon the enforcement of the federal securities laws by the Commission as well as by private parties * * * the Commission believes it is in the public interest for rehearing to be granted * * *" | "* * * the questions presented do not warrant review by this Court." |

The Government's strong approval of damage awards of this dimension leads it, however, to attempt to buttress the decision below by presenting a hypothetical reformulation (nowhere supported in the record) which it claims produces "almost identical damages" (Brief 23-24). Oddly, the Government's own reformulation adopts the erroneous $27 residual value figure which produces damages that include $15,000,000 for market loss!

In dismissing the award of $15,000,000 in damages for a market decline as not of "sufficient general importance to warrant review by this Court" (Brief 23), the Government ignores the fact that such an award is not ordinary judicial error. Congress has prohibited damage awards of that nature in Section 28 of the 1934 Act, as well as in Section 11 of the 1933 Act. A clearer ground for exercise of this Court's supervisory power is hard to imagine.

## Conclusion

The decision below accords Section 14(e) of the 1934 Act the most expansive scope conceivable and, as the Government acknowledges, raises several issues of the first importance to application of the federal securities laws as a coherent whole. This case presents a singularly appropriate occasion for review of these issues, and the SEC's endorsement of the new implied liability created below is not a ground for refusing review.



For the reasons stated herein and in our earlier submissions, a writ of certiorari should issue to the United States Court of Appeals for the Second Circuit.

Respectfully submitted,

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